No. 10287.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

Underwriting Members of Lloyd's in Lloyd's Policy Number 52342, and Stanley Graham Beer, individually and as representative of the Underwriting Members of Lloyd's Policy Number 52342,

Appellants,

vs.

California Fruit Growers Exchange, a corporation, and United States Fidelity and Guaranty Company, a corporation,

Appellees.

ANSWERING BRIEF OF APPELLEE UNITED STATES FIDELITY AND GUARANTY COMPANY.

Mills & Wood,

811 C. C. Chapman Building, Los Angeles,

Attorney for Appellee, United States Fidelity and Guaranty Company.

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No. 10287.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNDERWRITING MEMBERS OF LLOYD'S IN LLOYD'S POLICY NUMBER 52342, and STANLEY GRAHAM BEER, individually and as representative of the Underwriting Members of Lloyd's Policy Number 52342,

Appellants,

vs.

CALIFORNIA FRUIT GROWERS EXCHANGE, a corporation, and UNITED STATES FIDELITY AND GUARANTY COMPANY, a corporation,

Appellees.

ANSWERING BRIEF OF APPELLEE UNITED STATES FIDELITY AND GUARANTY COMPANY.

United States Fidelity and Guaranty Company respectfully submits its brief in answer to that of appellants.

Statement of Pleadings, Facts and Statutory Provisions.

The statement under this caption, by appellants, is in substance, correct, and at the outset need not be enlarged upon.

Statement of the Facts and of the Case.

Every fact not admitted by the pleadings, appears in the stipulations of the parties appearing in the record.

From these sources it appears that as of October 23, 1912, appellee United States Fidelity and Guaranty Company (sometimes for brevity referred to as "U.S.F. & G.") issued to plaintiff and appellee, California Fruit Growers Exchange (sometimes called "Fruit Growers") its schedule fidelity bond, referred to as ("Primary Bond"). This bond has remained in force continuously since that time, and is set forth in the transcript at pages 13 to 25, inclusive.

By that Primary Bond, appellee, U.S.F. & G., guaranteed to pay Fruit Growers, referred to therein as "The Employer", such pecuniary loss as the Employer shall sustain by acts of fraud, dishonesty, etc. by any of the employees of the Fruit Growers, listed under the bond, with a maximum of liability of $1,000.00 as to Floyd E. Jones, a listed employee of Fruit Growers, and that maximum of liability under that bond, continued throughout and including the times when the defalcations of Jones involved in this action, as shown by the stipulations hereinafter referred to, took place.

From the time of the execution of the Primary Bond until November 1, 1935, Fruit Growers carried no excess insurance as to any employee, so far as this record discloses.

On November 1, 1936, the appellants, Underwriting Members of Lloyd's (referred to as "Lloyd's"), executed and delivered to Fruit Growers their "Certificate of Insurance", shown at pages 26 to 33, inclusive, of the transcript, whereby Lloyd's insured Fruit Growers, "during

the period commencing with the 1st of November, 1936, and ending with the 1st of November, 1937, both days at noon, on Excess Blanket Fidelity in the amount of $25,000.00 over and above Primary Limit . . . on United States Fidelity and Guaranty Bond . . ." [Tr. p. 26.]

This Certificate of Insurance provides that it is to be used "as evidence that insurance described above has been effected, against which underwriter's certificate or policy will be duly issued by the Underwriters" [Tr. p. 27], and that "This Policy is to indemnify the Assured against all direct loss as the Assured may sustain by reason of the dishonesty of any employees in their employment who are bonded under a Bond or Bonds (hereinafter called Primary Bonds) issued by an approved Insurance Company, subject to the conditions hereinafter contained." [Tr. p. 28.]

By paragraph 4 of the Certificate and the policy it is provided:

> "4. It is further understood and agreed that this excess insurance is subject to all the terms and conditions of the said Primary Bonds insofar as the same do not conflict with the terms and conditions herein contained. . . ." [Tr. p. 29.]

And by paragraph 5 thereof, it is provided:

> "5. Warranted Free of all Claim for losses occurring subsequent to the expiry date of this Policy and for losses discovered during its currency, with the understanding that in event of non-renewal the Assured shall have a period equal to that provided by the Discovery Clause of the aforesaid Primary Bonds (but not exceeding three years) in which to discover losses claimable under this insurance." [Tr. p. 29.]

As of November 1, 1936, the formal bond of Lloyd's was issued covering the same period, the same amount, and with identical conditions and provisions as the Certificate theretofore issued, it being noted that both the Certificate and Policy afford coverage to Fruit Growers for "such portion of the ultimate net loss sustained by the Assured in respect of defalcations committed by any such employee subsequent to the 1st day of November, 1935, as shall be in excess of the amount for which such employee is bonded under said Primary Bonds, provided always that Underwriter's liability shall in no event exceed the sum of $25,000.00 in the aggregate." [Tr. pp. 28 and 36.]

The policy of Lloyd's expired on November 1, 1937, and was not renewed.

As of November 1, 1937, U.S.F. & G. issued to Fruit Growers its "Excess Commercial Blanket Bond" [Tr. pp. 55-61], by which it agreed to indemnify Fruit Growers "to an amount not exceeding in the aggregate, for all losses under this bond" in the sum of $25,000.00, "in excess of the amount or amounts carried under the primary fidelity suretyship" described therein [Tr. p. 55], which is its primary bond issued to Fruit Growers, on October 23, 1912 [Tr. p. 47], the excess losses being those committed by an employee, "during the term of this (excess) bond" and while this (excess) bond and said primary fidelity suretyship are in force." [Tr. pp. 45-46.] The term of the excess bond is prescribed as beginning with the 1st day of November, 1937, and ending at 12 o'clock night

on the effective date of the cancellation of the excess bond. [Tr. p. 46.]

On January 12, 1938, U.S.F. & G. attached to its excess bond a rider, wherein the policy of Lloyd's is referred to as the "prior bond" and which rider, so far as material to this action, reads as follows:

"UNITED STATES FIDELITY AND GUARANTY COMPANY
Baltimore, Maryland
Rider

No. 02-308-37 $....................

To be attached to and form a part of Excess Commercial Blanket Bond, (Standard Form AA) No. 14815-02-308-37, issued by the United States Fidelity and Guaranty Company, of Baltimore, Md., in the amount of Twenty-five Thousand Dollars ($25,-000.00), in favor of California Fruit Growers Exchange, *et al.* (hereinafter called Employer), and dated the 1st day of November, 1937.

Whereas, Lloyd's issued an Excess Blanket Fidelity Bond (hereinafter called the prior bond), effective the First day of November, 1936, in the amount of Twenty-five Thousand Dollars ($25,-000.00), and in favor of the Employer; and

Whereas, the prior bond, as of the effective date of the attached bond, has been terminated or cancelled by notice or agreement, as is evidenced by the issuance and acceptance of the attached bond and this rider;

Now, Therefore, it is hereby understood and agreed as follows:

1. That the attached bond shall be construed to cover, subject to its terms, conditions and limitations, any loss or losses under the prior bond which shall be discovered after the expiration of the time limited therein for the discovery of loss thereunder, and before the expiration of the time limited in the attached bond for the discovery of loss thereunder; provided that such loss or losses would have been recoverable under the prior bond had it not been cancelled or terminated; and provided further, that the acts or defaults causing such loss or losses be such as are covered under the attached bond on its effective date.

2. That nothing in the attached bond or this rider contained shall be construed as increasing the time for discovery of any loss or losses under the prior bond beyond what would have been the time for such discovery had the prior bond not been cancelled or terminated.

3. That liability under the attached bond as extended by this rider on account of loss or losses under the prior bond shall not exceed the amount of the attached bond on its effective date less all deductions on account of all payments made under the attached bond and the attached bond as extended by this rider, or the amount which would have been recoverable under the prior bond on account of such loss or losses had the prior bond not been cancelled or terminated, if the latter amount be the smaller." [Tr. pp. 62-63.]

The effect of this rider was to "pick up" or cover losses sustained during the currency of Lloyd's policy, but which were not discovered until *after* the expiration of the time limited in Lloyd's policy for discovery of losses sustained during the currency of Lloyd's policy, and expressly excluded coverage for losses sustained while Lloyd's policy was in force and discovered within the time specified therein for the discovery of losses thereunder.

And on November 1, 1938, U.S.F. & G. executed and delivered to Fruit Growers its "Excess Commercial Blanket Bond," by which it agreed to indemnify Fruit Growers in a similar amount as provided in its bond of November 1, 1937. This bond covers for losses sustained during its currency, and during the currency of the primary bond, and contains provisions similar to those contained in the prior 1937 bond. It has attached to and made a part of it, a rider similar in all respects to the rider attached to the 1937 bond, with this exception:

The rider attached to the 1937 bond refers to the Lloyd's policy as the "prior bond" [Tr. p. 62], while the 1938 bond refers to the U.S.F. & G. 1937 bond as the "prior bond". [Tr. p. 112.]

On March 19, 1942, a stipulation between Fruit Growers and U.S.F. & G. was entered into and was filed on March 20, 1942. [Tr. pp. 128-133.] On January 6, 1942, a like stipulation between Lloyd's and Fruit Growers was entered into and was filed March 20, 1942. [Tr. pp. 134-138.] Both these stipulations provide that from a date prior to May 1, 1937, to November 1, 1939,

one Floyd E. Jones was employed by Fruit Growers and was scheduled as an employee under the Primary Bond of U.S.F. & G.; that his defalcations during the period from May 1, 1937, to November 1, 1937, aggregate the sum of $23,019.22; that U.S.F. & G. paid the amount covered by its Primary Bond, and that these losses were of a nature as would be covered by the Primary Bond, by Lloyd's excess policy, and by the 1937 and 1938 bonds of U.S.F. & G. [Tr. pp. 130-131; p. 136.]

By a supplemental stipulation [Tr. pp. 186-193], it was agreed that the plaintiff, Fruit Growers, is entitled to recover the net excess loss of $22,019.22, after deducting the amount paid by U.S.F. & G. on its Primary Bond, against either Lloyd's or U.S.F. & G., Lloyd's agreeing that in the event the court should hold U.S.F. & G. not to be liable, judgment should be entered against Lloyd's for $22,019.22, and similarly, U.S.F. & G. agreed that in the event the court should find Lloyd's not to be liable, judgment should be entered against U.S.F. & G. for $22,019.22. [Tr. pp. 190-191.]

It was further provided in this stipulation that on July 31, 1940, plaintiff, Fruit Growers, discovered for the first time that said Floyd E. Jones might not have accounted for all moneys received by him on plaintiff's behalf [Tr. pp. 189-190]; further, that it is to be legally inferred that at the time Lloyd's issued its excess policy, Lloyd's was familiar with the terms and conditions of the Primary Bond of U.S.F. & G., and likewise, that it is to be

legally inferred that U.S.F. & G., at the time it issued its 1937 and 1938 bonds and riders thereto, it was familiar with the terms and conditions of Lloyd's excess policy and the Primary Bond. [Tr. p. 191.] It was further stipulated that no evidence need be introduced and that findings of fact and conclusions of law were waived.

Lloyd's contended that U.S.F. & G. was liable by reason of the riders attached to its bonds, and that Lloyd's liability ceased upon the termination of its excess policy, for all losses not discovered prior to that time.

U.S.F. & G. contended that Lloyd's was liable for all losses occurring during the currency of its policy, and discovered prior to the expiration of three years from the expiration and non-renewal of its excess policy on November 1, 1937, by reason of Condition 5 of its policy heretofore set out.

Upon the submission to the trial court of the case upon the stipulations, Honorable Harry A. Hollzer, judge presiding, on July 14, 1942, filed his opinion and memorandum of conclusions, finding that Lloyd's was liable [Tr. pp. 194-203], and judgment was entered accordingly. [Tr. pp. 205-207.]

As appellee, United States Fidelity and Guaranty Company, will conclusively show, none of the specifications of error assigned by appellant Lloyd's, are well taken, and for the sake of brevity, this appellee adopts the statement of events numbered 1 to 9, inclusive, as shown at page 13 and continuing on page 14 of the appellant's brief.

ARGUMENT.

I.

A Fidelity Bond Is Given a More Liberal Construction Than a Contract Involving the Rights of a Surety, and Fidelity Bonds Are Essentially Insurance Contracts. And to Hold That Appellants Are Not Liable Would Render the Controlling Provision of Lloyd's Policy Wholly Meaningless.

The controversy here involved and the correctness of the judgment of the trial court, depend essentially and primarily upon the correct interpretation of that clause or provision of Lloyd's policy which reads as follows:

> "5. Warranted Free of All Claim for losses occurring subsequent to the expiry date of this Policy and for losses not discovered during its currency, with the understanding that in the event of non-renewal the Assured shall have a period equal to that provided by the Discovery Clause of the aforesaid Primary Bonds (but not exceeding three years) in which to discover losses claimable under this Insurance." [Tr. p. 38.]

Appellee adopts the language of Judge Hollzer, in his opinion, as the true and correct rule of interpretation to be applied to this quoted provision, as follows:

> "The court concludes that in conformity with the fundamental rules of construction, every clause, every phrase, and every distinct provision in the policies sued upon herein should be given meaning and effect; that such meaning must be given, if possible, as will permit the particular policy involved to stand and leave no part useless, or deprived of all sense and meaning; that words should never be considered unnecessary and surplusage, if a reasonable construc-

tion can be adopted which will give force to and preserve all of the terms of such policy; that any construction should be avoided which implies that the party drawing the policy was ignorant of the meaning of the language employed, or that he used words in vain, the legal intendment being that each and every word or clause was inserted for some useful and sensible purpose, and that when rightly understood it may have some practical operation." [Tr. p 202.]

At page 32, and following, of appellants' brief, it is contended, as it was contended in the trial court, that the quoted provision or condition of Lloyd's policy should be broken up into separate and distinct clauses and so construed as to render all except the so-called "main clause" utterly devoid of any meaning or purpose whatever, and it is respectfully submitted that appellants, at page 35 of their brief, concede that to adopt the interpretation contended for, it is necessary to insert or read into the provision words that are not there, the added words being italicized by appellants.

In other words, if at the time Lloyd's policy was written, it had been the intention of the authors thereof, to have the policy mean what is now contended for, it would have been easy to accomplish that purpose by making the provision read as appellants designate the "main clause", as follows:

> "Warranted Free of all Claim for losses occurring subsequent to the expiry date of this Policy and for losses not discovered during its currency."

To have stopped there, would have left no question that the losses here involved would not have been covered, but

with the added language, as actually contained in the policy, it is equally clear that the provision means, and was intended to mean, that there was a period beyond the expiry date of Lloyd's policy, within which losses sustained or occurring during its currency might be discovered and be "claimable" under the policy. That period, by all reasonable construction, is three years from November 1, 1937. The losses here involved were discovered on July 31, 1940, within such three-year period.

The untenable claim of Lloyd's in this case, is made manifest by the simple suppositious case of a faithless employee, against whose dishonesty the Fruit Growers desired and paid for protection, should steal or misappropriate the moneys of the employer on the 31st day of October, 1937, and so cover up his defalcation that it was not discovered until November 2, 1937, and that Fruit Growers would then be informed that it did not have the protection it thought it had and for which it had paid.

In support of the judgment of the trial court in this case, appellee, United States Fidelity & Guaranty Company, cites the following:

Authorities.

(Unless otherwise stated, emphasis in quotations from authorities, are ours.)

> "Furthermore, it is a fidelity bond, and will be given a more liberal construction than a contract which involves only the pure question of the rights and obligations of a surety."

First State Bank v. Metropolitan Cas. Ins. Co., 79 S. W. (2d) 835 (citing Couch's Cyclopedia of Insurance Law, Vol. 5, Sec. 1199a, p. 4324, and authorities there cited).

"Bonds or contracts of those companies which guarantee the fidelity of employees and which make the business one for profit, are essentially insurance contracts * * *. Therefore the rights and liabilities of the parties are governed in case of ambiguity by the rules of construction applicable to insurance, rather than by the rule *strictissimi juris* which determines the rights of ordinary guarantors or sureties without pecuniary consideration. (Citing numerous authorities.)"

Joyce on Insurance (1918), Vol. 4, p. 4608, Sec. 2766.

"Another point to be considered in connection with risks and losses, is that fidelity guaranty insurance is a contract of indemnity; and inasmuch as obtaining full indemnity is the general purpose, it should not be defeated except by limitations which are expressly and clearly set forth without ambiguity in the contract. (Citing cases.)"

Joyce on Insurance (1918), Vol. 4, p. 4609, Sec. 2766 (119).

"The rule is well established that a contract of fidelity or insurance susceptible of two constructions, one favorable to the insured and the other to the insurer, should be construed favorable to the former."

Hartford Acc. & Ins. Co. v. Swedish Methodist Assn., 92 Fed. (2d) 649, at 652.

Citing:

First National Bank v. Hartford, etc., 95 U. S. 673, 678, 24 L. Ed. 563;

Thompson v. Phoenix Ins. Co., 136 U. S. 287, 10 S. Ct. 1019, 34 L. Ed. 408;

American Surety Co. v. Pauly, 170 U. S. 133, 18 S. Ct. 552, 42 L. Ed. 977.

See, also:

State Bank of Prague v. American Surety Co., 288 N. W. 7 (Minn.).

"It being entirely clear that within the contemplation of the parties, their stipulations were for the purpose of affording indemnity to the obligee, all substantial doubts with respect to the meaning of the terms they employ should be resolved to effectuate that obvious intention."

Joyce on Insurance (1918), Vol. 4, p. 4664, Sec. 2766.

See, also:

Century Digest, 4th Decennial Edition, "Insurance," Sec. 146(3), citing cases from all state and federal jurisdictions.

Court will not follow a refined construction of the language used by a surety in a fidelity bond, to defeat the promised and paid for protection under the bond.

Franklin Savings & T. Co. v. American Employers Ins. Co., 99 Fed. 494 (120).

In *Webster v. United States Fidelity and Guaranty Company,* 153 So. 159 (Miss.), the foregoing statements are supported. In that case it is said:

"When all the provisions of this rider are considered together, it appears that the only purpose of the claim last referred to is to continue the prior bond for the purpose of permitting a recovery *under the last bond for any losses recoverable under the prior bond.*"

"The last bond, which was executed May 14, 1928, contains no provisions requiring losses thereunder to be discovered within any fixed time to create liability therefore, and therefore the appellant is *entitled to recover under the terms and conditions thereof for losses occurring during the term thereof.*"

"We do not think the provision hereunder reviewed attempts to change or limit the statutory period for bringing suits, but it is rather one providing *what class of losses are covered and limiting liability* thereunder to those losses discovered within that period."

In *State Bank of Prague v. American Surety Co.*, 288 N. W. 7 (Minn.), the bond was in effect for one year. It provided for notice within a specified period after discovery and the filing of claim within three months after discovery.

It was contended that the defalcation was not within the coverage, because, while it resulted from acts done within the coverage period, there was no liability because not discovered until afterward.

At page 12 of the opinion, the Court says:

"The policy does not expressly provide that it only shall cover losses discovered during the coverage period. Where, as here, the insurance is to indemnify the insured against loss through the fraudulent and dishonest acts of his employee in connection with the duties of his employment, *the insurance covers all losses due to such acts committed during the coverage term,* whether *discovered during that time or afterwards.* United States v. Maryland Casualty Co., 4 Cir., 299 Fed. 942; Mid City Trust & Savings Bank v. National Surety Co., 202 Ill. App. 6. We decided Cary v. National Surety Co., 190 Minn. 185, 251 N.

W. 123, and Farmers Co-op. Exchange Co. v. U.S.F. & G. Co., 150 Minn., 184 N. W. 792, upon assumption that such was the rule."

"Where there is doubt as to the meaning of such a policy, it is construed in favor of the insured as providing for such coverage. The uniform practice in deference to such rule, when the intention was to limit coverage to losses discovered during the coverage period, or within a certain time thereafter, has been to so provide in express terms in the policy. (Citing cases.)

"* * * The failure to include such a limitation in the policy involved here, should be construed as showing an intention that there was to be none. Although the loss was not discovered until after the coverage period had expired, the policy covered the defalcation in question since it occurred during the coverage period."

Paragraph 5 of Lloyd's policy says: "Warranted free of all claims for losses occurring subsequent to the date of this policy and for losses not discovered during its currency," and if the provision stopped there, it would mean one thing, but immediately follows the qualifying language "with the understanding that in the event of non-renewal, the assured shall have a period equal to that provided by the Discovery clause of the aforesaid Primary Bonds (but not exceeding three years) in which to discover losses claimable under this insurance." The provision must be construed as a whole, and so construed, gives three years from non-renewal for the discovery of losses occurring within its currency.

The authorities cited by Lloyd's support the judgment of the trial court.

At pages 16 and 17 of appellants' brief are cited Section 1643 of the Civil Code of California, and the cases of

> *Robbins v. Pacific Eastern Corp.*, 8 Cal. (2d) 241, 273 (65 Pac. (2d) 42) and
>
> *Rabbitt v. Union Indemnity Co.*, 140 Cal. App. 575-585, 35 Pac. (2d) 42.

Appellee, likewise, cites these authorities, with particular emphasis on that portion of the quotation in the first cited case (*Robbins v. Pacific etc., supra*), wherein it is said that

> "* * * it is reasonable to suppose that the parties meant something by their agreement, and were not engaged in an attempt to do a vain and meaningless thing."

United States Fidelity and Guaranty Company's 1937 Excess Bond Does Not Cover the Losses Here Involved.

On November 1, 1937, U.S.F. & G. issued its bond referred to as its "1937 Bond", whereby it insured Fruit Growers for all losses under that bond, in a sum not exceeding $25,000.00 "in excess of the amount or amounts covered under the primary fidelity suretyship described in Section A, paragraph 2" [Tr. p. 45], which Primary Bond is described as its own "Schedule Bond No. 14815-03-62-12—favor California Fruit Growers Exchange, *et al.*" [Tr. p. 47], which is its bond dated October 23, 1912, and shown at pages 13 to 25, inclusive, of the transcript.

This 1937 Bond, as originally written, covered such excess losses as were sustained "during the term of this bond * * * and while this bond and said primary fidel-

ity suretyship are in force as to such Employee or Employees * * *" [Tr. pp. 45-46.]

The term of the 1937 bond is specified as beginning "with the 1st day of November, 1937, standard time at the address of the Employer above given and ends at 12 o'clock night, standard time as aforesaid, on the effective date of the cancellation of this bond." [Tr. p. 46.] The Primary Bond therein referred to has continued in force ever since its issuance on October 23, 1912.

On January 12, 1938, there was attached to the U.S.F. & G. 1937 bond, a rider which extended the coverage under it so as to cover losses which might have been sustained by Fruit Growers during the currency of Lloyd's policy and which such losses "shall be discovered *after* the expiration of the time limited therein (in Lloyd's policy) for the discovery of loss thereunder, and before the expiration of the time limited in the attached bond (the 1937 U.S.F. & G. bond) for the discovery of loss thereunder." [Tr. pp. 62-63.]

The rider in question reads as follows:

"Rider

No. 02-308-37 $......................

To be attached to and form a part of Excess Commercial Blanket Bond, (Standard Form AA) No. 14815-02-308-37, issued by the United States Fidelity and Guaranty Company, of Baltimore, Md., in the amount of Twenty-Five Thousand Dollars ($25,-000.00), in favor of California Fruit Growers Exchange, *et al.* (hereinafter called Employer), and dated the 1st day of November, 1937.

Whereas, Lloyds issued an Excess Blanket Fidelity Bond (hereinafter called the prior bond), effective

the First day of November, 1936, in the amount of Twenty-Five Thousand Dollars ($25,000.00), and in favor of the Employer; and

Whereas, the prior bond, as of the effective date of the attached bond, has been terminated or cancelled by notice or agreement, as is evidenced by the issuance and acceptance of the attached bond and this rider;

Now, Therefore, it is hereby understood and agreed as follows:

1. That the attached bond shall be construed to cover, subject to its terms, conditions and limitations, any loss or losses under the prior bond which shall be discovered after the expiration of the time limited in the attached bond for the discovery of loss thereunder; provided that such loss or losses would have been recoverable under the prior bond had it not been cancelled or terminated; and provided further, that the acts or defaults causing such loss or losses be such as are covered under the attached bond on its effective date.

2. That nothing in the attached bond or this rider contained shall be construed as increasing the time for discovery of any loss or losses under the prior bond beyond what would have been the time for such discovery had the prior bond not been cancelled or terminated.

3. That liability under the attached bond as extended by this rider on account of loss or losses under the prior bond shall not exceed the amount of the attached bond on its effective date less all deductions on account of all payments made under the attached bond and the attached bond as extended by this rider,

or the amount which would have been recoverable under the prior bond on account of such loss or losses had the prior bond not been cancelled or terminated, if the latter amount be the smaller.

4. That any sum or sums which shall be paid under the attached bond as extended by this rider on account of any loss or losses under the prior bond shall reduce or be deducted from the amount of the attached bond in the same manner and subject to the same conditions and limitations as payments under the attached bonds, but any sum so reducing or deducted from the amount of the attached bond shall be restored thereto as therein provided." [Tr. pp. 62-63.]

Neither this 1937 bond, nor the rider attached to it, nor both taken together, undertook to absolve Lloyd's from liability under the Lloyd's policy, or to take over or assume any liability of Lloyd's. All that was done, or intended to be done, was to extend coverage, under the rider, for losses occurring and sustained during the currency of Lloyd's policy, the right to recover which Fruit Growers may thereafter lose by failure to discover such losses within the time provided in clause 5 of Lloyd's policy, to-wit, within three years from the non-renewal of Lloyd's policy, it having expired by its own limitation on November 1, 1937.

All of the stipulated losses occurred during the currency of Lloyd's policy, that is, between May 1, 1937, and No-

vember 1, 1937. They were discovered on July 31, 1940 [Stipulation, par. 5, Tr. pp. 189-190], which was within the three year period for discovery as provided in Lloyd's policy.

Manifestly, therefore, any claim under the 1937 bond and rider alone, did not mature, for these several reasons:

1. The losses did not occur, or were not sustained, during the currency of that bond, that is, between November 1, 1937, and November 1, 1938;

2. They were discovered on July 31, 1940, which was not within twelve months after the termination of the 1937 bond, which terminated on November 1, 1938, when the 1938 bond was written;

3. The losses were sustained during the currency of the primary bond of U. S. F. & G., issued on October 23, 1912, which was in effect, and during the currency of Lloyd's policy, *viz.*, between May 1, 1937, and November 1, 1937.

4. They were discovered within three years from the non-renewal, on November 1, 1937, of the Lloyd's policy, and not *after* the time for discovery under Lloyd's policy.

5. The agreed losses are recoverable under Lloyd's policy, because they were sustained during the currency of that policy, and during the currency of the primary bond, and within the three year period for discovery, specified in Lloyd's policy.

As to the 1938 Bond of United States Fidelity and Guaranty Company.

On November 1, 1938, U. S. F. & G. issued to Fruit Growers its Excess Commercial Blanket Bond, shown at pages 91 to 121 of the transcript.

That bond is in every essential particular, like the 1937 bond, except as to term of its beginning, being on November 1, 1938. It likewise bore a rider substantially like that attached to the 1937 bond, which rider provides:

> "That the attached bond shall be construed to cover, subject to its terms, conditions and limitations, any loss or losses under the prior (1937) bond which shall be discovered after the expiration of the time limited therein for the discovery of loss thereunder and before the expiration of the time limited in the attached bond for the discovery of loss thereunder, provided that such loss or losses would have been recoverable under the prior (1937) bond had it not been cancelled or terminated; and provided further that the acts or defaults causing such loss or losses be such as are covered under the attached bond on its effective date." [Tr. p. 166.]

While the stipulated losses were not discovered within twelve months from the expiration of the 1937 bond and are not therefore recoverable under that bond, the 1938 bond was in force at the time of discovery on July 31, 1940, which carried forward the coverage under the 1937 bond, and, by force of the two bonds of 1937 and 1938, covers the losses involved if, and, only if, they are not recoverable under Lloyd's policy. They are not recoverable under that bond for the simple reason that they were discovered within the period for discovery provided in the Lloyd's policy.

The riders on the U. S. F. & G. bonds are clear and explicit in the provision:

> "That the attached bond shall be construed to cover, subject to its terms, conditions and limitations, any loss or losses under the prior bond which shall be discovered *after* the expiration of the time limited therein for the discovery of loss thereunder."

The losses occurred during the currency of Lloyd's policy and having been discovered within the period of three years from its non-renewal, they are recoverable under that policy and not recoverable under the 1937 or 1938 bonds of U. S. F. & G.

The Grammatical Construction Contended for By Lloyd's Is Not Tenable.

Under subdivisions II and IV of their brief, at pages 20, *et seq.* thereof, appellants take occasion to advert to the fact that many of the words used in Lloyd's policy, begin with capital letters, and that, among others, the words "Discovery Clause" are thus capitalized, and say that it obviously refers to a particular thing, and then inquire what becomes of those words, if there is no discovery clause in the primary bond.

To this it is replied that Lloyd's themselves, by the very language of their policy recognize that there was a period after the non-renewal of their policy, within which losses occurring during its currency may be covered and become "claimable under this Insurance," and when we consider that it is stipulated that, "It is to be legally inferred that at the time Lloyd's issued its excess policy, Lloyd's was familiar with the terms and conditions of the primary bond of U. S. F. & G." [Tr. p. 191], appellee wonders and

inquires if Lloyd's, at that time, had it in mind to so frame its own Discovery Clause as to make it meaningless, and so that there never could be any liability on Lloyd's for losses incurred during its currency, but not discovered during such currency?

It is to be assumed, in the absence of evidence to the contrary, that the premium paid for Lloyd's policy was commensurate with the coverage afforded or intended to be afforded thereby. Let us then assume that at the time of the presentation to Fruit Growers of Lloyd's policy, Fruit Growers had inquired of Lloyd's to say, just what does this discovery clause 5 in your policy mean? We think it fair to assume that Lloyd's would not then have said, as they now say, in substance, at page 23 of their brief:

> "This phrase is designed to cover the situation, if the primary policy contains a Discovery Clause. But if the primary policy does not contain a Discovery Clause, then the concluding clause in our policy is inoperative."

On the contrary, it is fair to assume that Lloyd's would, in response to such an inquiry, have said:

> "We are familiar with your primary bond. This provision is clear to the effect that you have a period not exceeding three years from the non-renewal of Lloyd's policy within which to discover losses occurring during the currency of Lloyd's policy, and if so discovered they are claimable under this insurance."

And, in the absence of just such a statement, it is not difficult to surmise that Lloyd's policy would never have been accepted. Such a construction comports with the language used and no other construction does.

The Losses Are Recoverable Under the Lloyd's Policy and Not Under Either the 1937 or 1938 Bonds of U. S. F. & G.

The losses occurred during the currency of Lloyd's policy. They were discovered within the time provided in that policy for their discovery. As the 1937 bond excluded coverage for losses sustained during the currency of Lloyd's policy and within the period provided therein for discovery, likewise the 1938 bond excluded coverage during the same period, and the losses are not recoverable under either the 1937 or 1938 bonds of U. S. F. & G., but are recoverable under the Lloyd's policy.

The following authorities demonstrate that there is no liability on U. S. F. & G. under the facts as they exist in the instant case.

In *London & Lancashire Ins. Co. v. Peoples Nat. Bank, etc.,* 59 Fed. (2d) 149, there was involved an identical situation as is involved under each of the bonds of United States Fidelity and Guaranty Company. There Metropolitan Casualty Insurance Company issued a fidelity bond covering losses sustained during its currency and discovered within two years after its termination. The bond was superseded by one executed by London & Lancashire Insurance Company, and upon the latter becoming effective, the Metropolitan bond was cancelled and a rider was attached to the new bond, which, after reciting that the period bond "may provide that any loss thereunder shall be discovered or claim therefor shall be filed, within a certain period after the final expiration or cancellation thereof" it is understood and agreed that the new bond should cover losses under the prior bond which shall be discovered *after* the expiration of the period for discovery, or,

if no such period, after the bar of the statute of limitations and before the expiration of the time limited in the new bond for discovery of losses under it, and which would have been recoverable under the prior bond if it had not been terminated. The language is almost identical with that contained in the 1937 and 1938 bonds of United States Fidelity and Guaranty Company. The Court says (p. 151):

> "A careful study of the rider convinces us that appellant did not thereby undertake the assumption of any and all liability which might accrue under the Metropolitan contract, but only such as, accruing while the Metropolitan contract was in force, would not, under that contract, be enforceable if not discovered within two years after the Metropolitan contract was terminated. By the terms of that contract, a loss occurring while it was in force would be recoverable if discovered within two years after termination of the contract; but if discovered more than two years after termination, no action would lie. Had the contract remained in force, the right of discovery would have persisted until the loss was discovered. Therefore, in canceling the Metropolitan contract the bank was deprived of the right of recovery for a loss occurring thereunder which was not discovered within two years after the cancellation. The new bond carried no indemnity against loss accruing prior to the issue, but not discovered within two years after the termination of the prior contract, that the rider was attached."

* * * * * * * *

> "This alleged loss having been discovered by the indemnified bank within two years after the cancellation of the Metropolitan contract, it follows that it

is not a loss for which appellant, by its rider, assumed to indemnify appellee, and it was not recoverable against appellant. It will therefore be unnecessary to inquire into the merits of the contention respecting Maple's alleged dishonest acts as the cause of that asserted item of loss."

In *Hartford Acc. & Ind. Co. v. Collins-Dietz Morris Co.,* 80 Fed. (2d) 441, a similar rider was involved. At page 445, the Court says:

> "The rider in question applies only to shortages which occurred during the currency of the bond of 1929 and which were discovered *more than* two years after that bond terminated. In other words, it applies exclusively to losses which were sustained prior to October 1, 1932."

Citing:

> *London & Lancashire Inc. Co. v. Peoples Nat. Bank, supra* (50 Fed. (2d) 149);
>
> *Maryland Casualty Co. v. First Nat. Bank,* 246 Fed. 892;
>
> *Hartford Acc. & Ind. Co. v. Collins-Dietz, etc.,* 80 Fed. (2d) 441.

In the last case cited, Metropolitan Casualty Insurance Company executed a fidelity bond dated March 4, 1927, which expired October 1, 1929. On October 1, 1929, Hartford Accident and Indemnity Company executed its bond, which terminated October 1, 1930. This bond covered losses occurring while it was in force and discovered within two years after its termination.

To this latter bond a rider was attached providing that the bond to which the rider was attached, should cover

losses covered under the Metropolitan bond "which shall be discovered after the expiration of any such period, or, if there be no such period, after the bar of the statute of limitations, and before the expiration of the time limited in the attached bond for loss thereunder—and which would have been recoverable under said fidelity suretyship (the Metropolitan bond) had it continued in force and also under the attached bond had such loss or losses occurred during the currency thereof."

A third bond was executed by the Hartford Company on October 1, 1930, which terminated one year later. Its material provisions were identical with those contained in the previous bond, except that it referred to the previous bond of the same company. Of this rider the Court said (p. 245):

> "The rider in question applies *only* to shortages which occurred during the currency of the bond in 1929 and which were discovered *more than* two years after that bond terminated. In other words, it applies exclusively to losses which were sustained *prior* to October 1, 1930, and which were not discovered until *after* October 1, 1932. Maryland Casualty Company v. First National Bank (C. C. A.), 246 Fed. 892; London & Lancashire Indemnity Co. v. Peoples National Bank (C. C. A), 59 F. (2d) 149. There were no such shortages. All shortages were discovered before October 1, 1932."

Maryland Casualty Co. v. Tulsa, etc., 83 Fed. (2d) 14, cites *Hartford v. Collins-Dietz, supra,* and says:

> "The rider has exclusive reference to losses which were suffered during the existence of the first bond and discovered more than two years after its termination. The limitation is a part of the rider and is

likewise limited to losses of that kind. There are no such losses here. All of these losses were discovered less than two years after the first bond was terminated and for that reason no recovery is sought under the terms of the rider. Accordingly, the rider including its fixation of maximum recovery has no effect here. We so held quite recently in construing an appended rider identical in all respects with this one. Hartford Accident & Indemnity Co. v. Collins-Dietz-Morris Co (C. C. A.), 80 Fed. (2d) 441."

As to Appellants' Contention of Contemporaneous Construction.

This argument under subdivision II of appellants' brief (p. 10), is evidently based upon the fact that the superseded suretyship rider attached to the 1937 bond was placed thereon some time after the bond was issued, and appellants challenge appellee to answer the argument.

No difficulty is encountered in this respect. The assumption that the placing of the rider on the bond amounted to a construction that there was no liability under Lloyd's policy, is wholly unwarranted. There is no evidence on the question whatever, and it is of no concern whatever to Lloyd's what either the Fruit Growers or U. S. F. & G., or both of them, thought about Lloyd's policy when or before the rider was attached. Their thoughts upon the matter could not change Lloyd's position or liability in any respect. The rider does not change or seek to change any of the provisions of Lloyd's policy. Lloyd's obligation under its policy remained the same at

the time the rider was attached as it was, and is, both before and since that event. It is quite as tenable to argue that both the Fruit Growers and U. S. F. & G. may have first thought that the three year period for discovery of losses was sufficient to protect against reasonable eventualities. It may have been that it was a pure oversight in not placing the rider on the bond at the time it was written. It may as well have been that there was a question of premiums to be paid, depending upon the extent of coverage to be extended by U. S. F. & G. From whatever angle the matter is to be approached, it amounts to nothing more than that for the period during which there was no rider on the bond, United States Fidelity and Guaranty Company had not bound itself to assume any liability for losses occurring during the currency of Lloyd's policy, no matter when they were discovered, and that after the affixing of the rider, it did assume the limited liability for such losses as were discovered *after* the expiration of the period of discovery provided in Lloyd's policy. But all these assumptions, we repeat, never prejudiced or advantaged Lloyd's in any manner or to any extent.

The proposition advanced and the authorities cited by appellants at pages 18 and 19 of their brief, can have no possible application here, for the obvious reason that Lloyd's liability was not in any manner affected by any bond or bonds thereafter issued by U. S. F. & G. and Lloyd's policy must stand or fall upon the purpose and intent and as expressed therein.

The Construction of Lloyd's Policy Contended for by Appellants Is Untenable and Not Supported by Any Authorities.

As this question is discussed by appellants under divisions II and III of their brief, appellee will direct its reply thereto under the above caption.

Appellants do not deny that it was the purpose and intent of Lloyd's policy to furnish and afford to Fruit Growers insurance or indemnity for losses in excess of the coverage of $1,000.00 under the primary bond of U. S. F. & G. and occurring or sustained during the period from November 1, 1936, to November 1, 1937.

But it is contended that the clause or provision of that policy, numbered 5, should be so construed as to reject and hold meaningless all of that clause or provision except so much thereof as reads:

> "Warranted free of all claims for losses occurring subsequent to the expiry date of this Policy and for losses not discovered within its currency."

Appellee submits that according to the provisions of the Civil Code and Code of Civil Procedure of California, cited by appellants at pages 20 and 21 of their brief, when applied to the facts of this case, lead only to the conclusion that the construction of this clause as found by Judge Hollzer, is correct.

The case of *Loyalton, etc. v. California, etc.*, 22 Cal. App. 75 (133 Pac. 323), cited by appellants, did not involve a contract of insurance such as is here involved, and a reading of that case will disclose that the court did not there read out of the contract in question any of its provisions.

Turning, then, to those authorities cited on page 30 of appellants' brief, there can be no question but that the courts have upheld discovery clauses in fidelity insurance contracts, and that is precisely what the trial court did in the instant case, and correctly so.

The cases cited by appellant at page 30 of their brief hold nothing more than that discovery clauses do not contravene any public policy, and that recovery will be allowed when discovery is made within the period prescribed, or denied if they are not so discovered. Lloyd's inserted in their policy a provision for the discovery of losses but now seeks to avoid it by argument that it does not say what it means, or mean what it says.

And appellee subscribes to the correctness of the rule laid down in 23 *Cal. Jur.* 758, section 133, as set forth on pages 31 and 32 of appellants' brief, when applied to the construction of statutes or code sections, and applying the same principles to an insurance contract, the court will apply the rule that the contract is to be construed as a whole, so as to give meaning and effect, not only as a whole "but to each and every part thereof—*i.e.* to every word and clause, and certainly to every distinct or co-ordinate provision or section"; that such meaning must be given, if possible, as will permit the whole to stand "and leave no part useless, or deprived of all sense and meaning"; that words are not considered unnecessary or as surplusage, and that "each and every word or clause was inserted for some useful and sensible purpose."

Appellants, at page 35, cite the case of *American Employers' Inc. Co. v. Roundup Coal Mining Company*, 73 Fed. (2d) 592. In that case the insurance company contended that a prior company could not limit the time for

discovery to two years by reason of a Nebraska statute, and the court held that the statute did not apply and there was nothing in it "to prohibit an insurance company from limiting its coverage to losses incurred during the life of the policy and discovery within two years thereafter." (Page 594.) There the defendant was held liable under a provision in its policy covering losses discovered after the period of discovery in the prior policy, it being apparent from the decision that it did not involve losses discovered within the time limited in the prior policy, as in the instant case.

The case of *Caldwell v. Center,* 30 Cal. 539, cited by appellants, has no bearing upon the instant case. In the first place, it did not involve an insurance policy, to which the rules of construction, as herein set forth, are applied. In the next place, it did not really involve the construction of a contract at all, except so far as to whether, under the contract, certain evidence was admissible. This is made clear from the quotations from the case as set out in the brief of appellants. There, a deed referred to a map recorded in the Recorder's office, which the Court found was not sufficient to describe the premises, and as the Court says:

> "The only evidence introduced by the plaintiff for this purpose was a map from the Recorder's office and a map from the Surveyor's office, *and parol testimony* in explanation of the last map. The defendant objected to the map from the Recorder's office on the grounds, among others, that 'it was made with pencil and not with ink', and that 'it was pasted in between the leaves of the book, but not recorded.' The court holds that the objection should have been sustained."

As opposed to the authorities cited and the argument advanced by appellants, appellee directs attention to the following:

In *Hartford Acc. & Ind. Co. v. Swedish Methodist Assn.*, 92 Fed. (2d) 649, at 651, provisions of a policy of fidelity insurance were involved, and there contentions similar to those of Lloyd's were made, and the Court said:

> "By the paragraph first referred to, appellant assumed certain obligations arising by reason of the first bond, and in the next paragraph disclaimed such obligations; by the former paragraph certain rights were bestowed upon the insured, and by the latter paragraph they were denied. Just why an instrument so confusing and contradictory in its terms should be employed, we do not know, and do not care to hazard a guess. *If the rider means what is claimed by appellant, it seems it would have been a rather easy matter to have so stated in terms which could be readily understood.*"

Appellants appear to concede that the entire clause 5 of their policy is to be construed together, but, in the same breath, they seek to divide that clause into subdivisions in such a manner as to utterly read out of it all of its substance, and so as to destroy the provision entirely, when if it was intended to be construed as now contended for, it would have been very easy to have said so in language that could not have been misunderstood, and in which event it may be reasonably assumed that the Fruit Growers would not have accepted the policy. It is submitted that no authority cited by appellants sustains their contention.

If it had been the intention of Lloyd's and Fruit Growers that the provision in Lloyd's policy should be construed as now contended for, then, as suggested in the *Hartford* case, *supra,* "it would have been a rather easy matter to have so stated in terms which could be readily understood," and in that event the provision would have read, "Warranted free of all claim for losses occurring subsequent to the expiry date of this Policy and for losses not discovered during its currency," and have stopped there.

Again, as opposed to the authorities cited by appellants, the following are of interest:

In *Stein v. Archibald,* 151 Cal. 220, at page 223, it is said:

> "It is a well settled principle, applicable to the construction of contracts, that when one construction would make the contract unreasonable, unfair or unusual and extraordinary, and another construction, equally consistent with the language, would make it reasonable, fair and just, that the latter construction is the one which must be adopted."

This case was cited to the same effect in *Stoddard v. Holden,* 179 Cal. 663, at 665, and *Van Demark v. California etc.,* 43 Cal. App. 685, at 690.

In *California R. Co. v. Producers R. Corp.,* 25 Cal. App. (2d) 104, it is said, at page 107:

> "It is true, as stated in section 1641 of the Civil Code, that the whole of a contract should be construed together, so as to give effect to every part thereof, if it is reasonably practical to do so. And Section 1858 of the Code of Civil Procedure provides that:

" 'In the construction of a statute or instrument, the office of the judge is simply to ascertain and declare what is in terms or in substance contained therein, not to insert what has been omitted, or to omit what has been inserted; and when there are several provisions or particulars, such a construction is, if possible, to be adopted as will give effect to all.' "

Applying the rules, the provision shows a clear purpose and intent to afford a discovery period of not to exceed three years from the expiration of Lloyd's policy, and to distort or reject all that follows what is termed the main clause would be neither fair nor just.

As suggested, it never was intended by Lloyd's to so frame its policy as to deny coverage of a loss sustained on the last day of the policy, because it was not also discovered on that day, but was intended to extend coverage for not to exceed three years from the non-renewal of its policy.

The Rules of Construction of Lloyd's Policy Are Applicable, Notwithstanding the Relations of the Parties to This Controversy.

The final contention of appellants is that it is not open to U. S. F. & G. to urge the usual, ordinary and well established rules that must be applied when considering the provisions of Lloyd's policy.

The case of *"The Grecian,"* 78 Fed. (2d) 657, is cited in support of the contention.

As applied to the facts in that case, no fault can be found with the cited quotation therefrom, but it has no application to the situation here presented. As we read that case, it was one in which one vessel, or the owners

thereof, and of the cargo, sought to recover from a colliding vessel the value of the cargo lost, in other words, a negligence action. The respondent vessel sought to defend upon the ground, among others, that the complaining vessel, or its owners, did carry or were required to carry insurance upon the cargo. The Court did use the language quoted by appellants at pages 39 and 40 of their brief. But in doing so, the Court went no further than to apply the familiar rule that when one whose property is damaged or destroyed by another, the offending party may not show the carrying of insurance by the injured person to avoid his own tort liability. That situation does not obtain here. Neither U. S. F. & G. nor Lloyd's is seeking to recover from the other. This is not a tort action. It is a declaratory action brought by Fruit Growers to determine which of the defendants is liable to Fruit Growers for a loss sustained by it. And if it is not competent for U. S. F. & G. to urge the rules by which Lloyd's policy is to be construed, then by what right does Lloyd's argue or urge the construction of U. S. F. & G. bonds?

Answering the argument of Lloyd's, at pages 38 and 39 of their brief, that the rules of liberal construction should be equally applied to Lloyd's and to U. S. F. & G., appellee submits that the riders attached to its bonds are clear, definite and unequivocal, showing without ambiguity when liability is to be assumed for losses occurring during the currency of Lloyd's policy.

The clear and concise provision of the riders attached to the excess bonds of U. S. F. & G. is that that Company is not liable to Fruit Growers for any loss sustained by Fruit Growers during the currency of Lloyd's policy and discovered within the period for discovery under Lloyd's policy. It did not undertake to relieve or release Lloyd's from any liability, but left that liability to rest where Lloyd's placed it by their policy. The only time when there could be any liability on U. S. F. & G. for losses occurring during the currency of Lloyd's policy was in the event Fruit Growers should fail to discover such losses within the period for discovery, as provided in Lloyd's policy, and had thus lost its right of recovery against Lloyd's. That eventuality never happened, and thus no liability has ever attached to U. S. F. & G., but rests where it always has rested, upon Lloyd's alone.

The authorities cited herein clearly and beyond question definitely impose liability upon Lloyd's and as clearly and definitely exonerate U. S. F. & G. from liability.

And replying to the conclusion of appellants that to hold Lloyd's liable is to attribute to U. S. F. & G. the doing of a useless and meaningless act, appellee replies that if the stipulated losses had been discovered subsequent to the expiration of three years from the non-renewal of Lloyd's policy, U. S. F. & G. would have been responsible for them under its 1938 bond, but they were not so discovered.

As to the Brief of Appellee, California Fruit Growers Exchange.

It correctly and properly shows the position of Fruit Growers in this case and correctly sets forth the effect of the stipulations entered into and that judgment was entered pursuant to the stipulations. U. S. F. & G. abides by the stipulations and submits that the judgment against Lloyd's should be affirmed.

Conclusion.

In conclusion appellee submits:

1. That the single question to be determined is the purpose, intent and effect of clause 5 contained in Lloyd's policy.

2. To hold and construe that clause as contended by Lloyd's renders it repugnant to the evident and expressed purpose and intent of Lloyd's to provide a period beyond the non-renewal of Lloyd's policy, within which Fruit Growers might discover losses sustained during the currency of that policy and make them "claimable" under the policy as expressed in the clause.

3. That the stipulated losses, having been suffered or sustained during the currency of Lloyd's policy and having been discovered within three years from the non-renewal of Lloyd's policy on November 1, 1938, renders Lloyd's liable therefor and gives effect to all and each part of clause 5.

4. To hold U. S. F. & G. liable would be to construe the riders to its bonds as covering losses never intended to be covered, it having agreed to become liable for losses sustained under Lloyd's policy only in the event of their discovery after, and not within, the three year period for discovery as provided in Lloyd's policy.

5. To absolve Lloyd's from liability would mean that they received a premium for an obligation covered by their policy and which they now seek to repudiate.

6. And the judgment of the trial court should be affirmed.

Respectfully submitted,

MILLS & WOOD,

By EDWARD C. MILLS,

Attorney for Appellee, United States Fidelity and Guaranty Company.